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Appendix 7(a)

LOCAL AUTHORITY COMPANY REVIEW GUIDANCE

A toolkit for undertaking strategic and governance reviews of wholly or partly owned council commercial entities – 2023 edition

LOCAL
PARTNERSHIPS

1 FOREWORD

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Why is this guidance needed?

Local authority-controlled companies continue to be a popular model for carrying out commercial activity. Whilst there have been a few high-profile failures, there remain a significant number that are successful, taking advantage of the freedoms enjoyed by operating outside the council itself.

However, given the current uncertainties in the general economic landscape including increased borrowing rates, it is important to ensure that all councils who own such companies maintain a watching brief on them and make any necessary adjustments. This could entail changes to the structure, shareholding or indeed to bring the operation back in-house. Close monitoring of companies' performance and those who operate them is all the more important.

It is always important to recognise that the skills required to operate a company are distinct from those needed within a council. Ensuring that the skills mix is appropriate also requires a watching brief.
When I first took over as the chair of a company, jointly owned by two London boroughs, I was surprised by the amount of time we spent considering cash flow, with profitability being a second order issue.
I had never had such a conversation inside my authority because cash flow is never an issue. Strong commercial financial skills are sometimes under-estimated and are all the more critical in these challenging economic times. The skills that are essential for success are not always found with the existing cadre of Members and Officers and authorities need to recognise the importance of the duty owed to the company, not the council in selecting Directors.

In some cases, it is not clear why councils choose to have a company as opposed to retaining the commercial activity in-house; and over time, what may have been an appropriate decision may no longer be the case.

There can be some significant benefits to having a company, but given the high-profile failures in recent times, they are in the spotlight and councils need to be aware of the challenges associated with having one.

This guidance has been refreshed to take into account these recent challenges and provide resources to support councils as they navigate what lies ahead.

In this guidance document

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INTRODUCTION

2.1 Background

Many councils have established wholly or partly owned companies, covering a diverse range of offerings. These include selling services to other public bodies, providing leisure or cultural facilities or establishing vehicles to manage or invest in revenue generating assets such as affordable housing or commercial property.

Some of these companies have been successful, generating a healthy return on investment and delivering recognised benefits and positive outcomes. Others have generated negative headlines for the wrong reasons.

Whether successful or not, many councils have seen the need to review their companies. In some cases, councils seek assurance that the governance structures and processes for managing risk are sufficiently robust. Other local authorities want assurance that the entities are meeting councils' expectations, delivering real benefits, and providing value for money.

This desire to review entities has recently escalated in part due to the COVID-19 pandemic which has revealed areas where councils are exposed to significant risk.

We have also witnessed several well-publicised issues with company governance at a number of councils, with the Government making direct interventions, rapid reviews and best value inspections. Public Interest Reports have also been published in the case of the high-profile failures, some of which are highlighted as case studies in Section 10.

This report has been updated in 2023 to provide good practice advice and to support the local government sector as it navigates the current challenging economic landscape.

> ...a tool to help councils ensure that they strike an appropriate balance between allowing a company the freedom to manage its activities and ensuring that it is accountable for its actions.

2.2 Purpose

As this guidance is primarily aimed at reviews of existing council owned companies, the first sections focus on the effectiveness and appropriateness of governance arrangements that are critical so that the companies may be held to account and to protect the interests of taxpayers.

Sections 3 and 4 of this guidance provide a best practice checklist of issues to consider while conducting governance reviews. Section 3 focuses on **councils'** governance arrangements for overseeing wholly or partly owned entities and holding them to account.

Section 4 focuses on the establishment of effective governance arrangements for the **entities** themselves.

Section 5 has been included for context, and sets out the questions and challenges that we believe are relevant to the decision-making processes for establishing wholly or partly owned entities; why is establishing a company the right approach and would an alternative delivery model be more appropriate? It provides guidance as well as questions and issues to address as part of the process to plan and approve the establishment of a commercial entity.

This guidance can be used as a tool to help councils ensure that they strike an appropriate balance between allowing a company the freedom to manage its activities and ensuring that it is accountable for its actions. A summary of evidence and an accompanying action sheet is provided in Section 9.

3
COUNCIL GOVERNANCE ARRANGEMENTS

3.1 Introduction

This section provides a best practice checklist of issues to be considered when reviewing wholly or partly owned entities, focusing on councils' governance arrangements for overseeing the entities and holding them to account.

Teams undertaking reviews should include representatives from the council's shareholder function as well as finance, legal, HR and commercial resource input.

The guidance does not suggest how regularly governance reviews should be undertaken because this will be dependent on a number of factors including the nature of the company business and its associated risk profile and where it is in terms of its life cycle (e.g. in a setup or steady state phase). Nevertheless, it is important for councils to be continually asking themselves if an entity is fit for purpose and not leaving it to the company itself to "mark its own homework".

3.2 Governance aims

Good corporate governance requires councils to carry out their functions in a way that demonstrates accountability, transparency, effectiveness, value, integrity, and inclusivity.

The governance arrangements for council owned entities should seek to ensure that:

- the entity should have sufficient freedoms to achieve its objectives
- the council should have sufficient control to ensure that its investment is protected, appropriate returns on investment can be obtained and that the activities of the entity are aligned with the values and strategic objectives of the council
- the entity continues to be relevant and required (in its existing form) and if not, appropriate steps are taken (for example, amending constitutional documents or changing form or terminating the vehicle)

The audit report on Nottingham City Council's arrangements relating to its company, Robin Hood Energy, stresses the need to ensure that "**sufficient checks and balances are in place and in particular that risks are appropriately recognised and managed, that there is an effective scrutiny function and that challenge of political priorities by both members and officers is seen as a positive**" and provides an important message that all councils establishing commercial entities should be cognisant of the risk of what is referred to as "**institutional blindness**" whereby effective governance arrangements are overshadowed by a council's determination that the company should be a success.

Generally, although not in all cases, it would be expected that an entity which is a trading company will have more autonomy than a Teckal company. Also, the amount of autonomy will depend on the size and scale of the business, the board make up, the size of any debt owed to the council or wider dependency on public sector loans or grants.

Any so-called "Teckal"[1] companies should remain compliant with relevant exemption requirements under EU procurement law.

EVIDENCE

C1 There should be evidence that the council and senior management recognise the importance of establishing appropriate and proportionate governance arrangements for the oversight of entities

C2 There should be evidence of a culture of challenge and clarity relating to the purpose, efficiency, effectiveness, specific objectives, and freedoms of the entity

3.3 The council's shareholder role

The council must have a designated "shareholder" to represent its ownership of the entity The process for appointing a shareholder needs to be set out in the council's constitution which should also detail how the shareholder reports on the exercise of their delegated powers.

[1] The case of *Teckal Srl v Comune di Viano and Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia (Case C-107/98) [1999] ECR I-8121]* established how a contracting authority could procure direct from an external company in which it has control similar to that it exerts over its own departments. Subject to meeting certain criteria (Reg12 of the Public Contracts Regulations 2015), procurement would be outside rules regulating the procurement of public contracts.

The shareholder may also have responsibility for liaison between the council and the entity and for access to information, although this role may also be vested in a distinct "contract officer" role.

The council may require that certain decisions of the shareholder (within the council's typical levels of materiality and thresholds in its schemes of delegation) require ratification by the Section 151 Officer and/or Monitoring Officer.

Councils may decide to delegate the shareholder function to a shareholder committee or board of the council or to the executive rather than to a designated individual.

The role of the shareholder should be to provide:

- oversight of any decisions that can only be made by the shareholder, rather than left to the entity (known as "reserved matters"). These may cover areas such as the approval of the annual business plan; key appointments; setting up subsidiaries; borrowing money; giving guarantees; approval of significant contracts (above a specified threshold); charging or mortgaging assets; buying or selling significant assets; or winding up
- a mechanism to review the implementation and development of the council's commercial approach through the entities it influences and owns
- the necessary oversight from a shareholder's perspective that the parameters, policies and boundaries that the council has established are being adhered to
- an articulation of what success looks like in terms of achieving social outcomes and a return on investment
- effective and systematic engagement between the chair/chief executive and shareholder function/role to assure effective performance against strategy and governance
- a mechanism to communicate the shareholder's views to the entity
- a means to evaluate the effectiveness of the company board and the delivery of the company performance against strategic objectives and the business plan
- a regular review of whether the entity provides the most effective vehicle to deliver the outcomes it requires and whether there are viable alternative models which might offer a more effective means of delivering its priorities
- a holistic review of risk to the council offered by all active entities carried out or moderated by an officer or a third-party professional who does not have a role within the relevant entities (i.e. not by an officer who is also a director of the entities)

The shareholder or their designated representative may attend company board meetings as observers, but they should not be there as board members.

An up-to-date shareholder's agreement should describe the powers of the board of the entity and how and when the shareholder might influence those powers. This can help demonstrate the required level of council control over any Teckal companies.

For trading and investment companies, it can lay out how the entity is independent from the council to ensure it is not treated as a public sector entity.

If the council is the sole shareholder, a formal shareholder's agreement may not necessarily be required. However, it is good practice to document such an agreement to ensure that there is no doubt about the powers of a company board to take decisions without the approval of the shareholder. It is also important to prevent unwarranted interference by council officers or members in the entity's affairs.

EVIDENCE

C3 There should be a clearly designated council shareholder role or function which is both understood and recognised by the council and the entity (and documented in terms of reference)

C4 There should be clarity regarding the role of shareholder, with reserved matters clearly documented and updated as required, reflecting any changes made as the entity has developed, in a shareholder's agreement, or as set out in the company's governing articles of association

C5 There should be evidence that the individual undertaking the shareholder role is provided with suitable training and support commensurate with the role and is independent of the company. This responsibility may be delegated to a committee rather than an individual. If this is the case, there must be a terms of reference drawn up and a suitable cohort of elected members identified to sit on the committee

C6 There should be evidence of formal periodic shareholder/chair/chief executive meetings with effective supporting papers to inform subsequent company board meetings

3.4 Council oversight, scrutiny, and governance framework

The council should have a clear, systematic framework which underpins arrangements for overseeing and engaging with entities to ensure its interests are safeguarded.

The framework should be underpinned by clear governance principles, such as keeping the role of shareholder separate from that of the board and applying arrangements in a similar legal model, by using standard articles of association or shareholder's agreements so that the overall approach is standardised.

The council should regularly undertake an objective assessment of how successfully each entity supports its policies and strategies. The appropriate time for such a review will depend on the nature of the entity but such matters should be considered as part of the annual business planning and budget setting process, with in-depth reviews carried out every three-five years as appropriate.

The council should regularly review risks relating to its entities and establish whether they are effectively managed and scrutinised. Different types of entities will be exposed to different risks. For example, development/asset-based companies will be constrained by any changes to council borrowing powers, whereas service-based companies will potentially be impacted by Teckal constraints around growth. Moreover, consideration of risks relating to the company should be included within the council's own risk management arrangements and financial planning.

The council's approach to governance should be determined by whether it wholly or partly owns several distinct entities or whether it funnels its interests through a holding company. A group structure may provide a single point of focus for managing the council's commercial activity and an effective use of resources.

For councils with a cabinet system, the council should establish a company management committee which should be a sub-committee of cabinet to look at the totality of a council's holdings and the decisions of that body should be subject to scrutiny.

For councils with a committee system, a designated committee, such as a resources committee, will be responsible for approving the establishment of a new entity. As part of their overview role within that committee Members will also advise on and scrutinise the decisions relating to the entity which are made on the council's behalf.

For those councils which have one or more overview and scrutiny committees (or equivalent), the committee should provide overview, pre-decision scrutiny and call-in of decisions regarding the council's shareholding interest in its entities. The council may wish to programme formal oversight and scrutiny reviews which focus on whether the financial and social objectives of the entity are being delivered.

The council's scrutiny role specifically includes:

- challenging the fundamental purpose of entities, assessing whether the council has a coherent strategy which articulates a common understanding of what the council is trying to achieve through its companies and how it is going about it
- bringing to bear direct knowledge and understanding of the needs of local people and meaningful, independent democratic oversight
- helping to design systems for scrutiny of companies which are accountable and transparent, and which intelligently involve local people (as well as involving scrutiny itself)
- considering the capability of the council and its entities to succeed in achieving their objectives
- considering whether commercial ventures and investments are being established for the right reasons
- reviewing risks relating to commercial investments, tolerance for risk, ownership of risks and processes for managing risk

It should be noted that this scrutiny role is distinct from that of "decision-making" members whose roles in signing off the establishment of entities could lead to the impression that they are conflicted when it comes to overall stewardship of companies if they were also to be involved in scrutiny. As such, members should not be on a shareholder board/panel if they are also part of a relevant scrutiny committee/panel (or vice versa).

One of the roles of the council's audit committee should be to pay specific attention to how the integration of the various external auditors across all its entities is achieved.

The council should ensure, that reviews of entities by committee or executive are as open and transparent as possible (subject to any redactions required for commercial confidentiality) including being able to be viewed by the public.

Reviews of entities should also feed into the council's annual review of its own governance and in turn into the Annual Governance Statement and should include findings and learnings from reviews relating to areas such as risk management, transparency, capacity, and capability. Furthermore, councils should ensure that the contribution of the company to the delivery of the council plan is made clear and is reflected in both corporate and company performance monitoring. The frequency of such reviews will depend on the nature of the entity but should be at least annually to ensure that the entity remains aligned to the owning council's objectives, and more often if needed e.g. if the company is about to embark on a new phase of activity.

It is important to note that there are number of distinct governance roles to be undertaken by various council personnel and functions. These include:

- "intelligent client" – an individual or group of individuals (working as or on behalf of the shareholder) who are tasked with ensuring that the council gains the desired outcomes from its arrangements with the entity. Specifically, they need to be able to challenge the entity, holding it to account using performance data to ensure there is clarity about what is being provided for the council and whether it meets expectations
- council Chief Executive, Section 151 Officer and Monitoring Officer need to be engaged regarding the ongoing purpose and performance of entities. This could be achieved by attending Shareholder Committee meetings as an observer

EVIDENCE

C7	There should be documented evidence of transparent member and officer scrutiny, oversight, and approval of business plans
C8	There should be evidence of a clear set of KPIs that fall out of the business planning process
C9	There should be evidence that senior company staff are performance managed against KPIs
C10	There should be evidence of ongoing assessment of value for money and quality offered by the entity through an adequately resourced monitoring function

C11 There should be ongoing assessment of risks relating to the entity, supported by processes to ensure that risks are managed as part of the council's overall risk management approach, with appropriate escalation and reporting

C12 There should be evidence of a consistent approach across the council when it comes to engaging with its entities

C13 The council should have clear and unfettered access to audited accounts for its entities

C14 There should be evidence of clear alignment between governance of entities and wider governance of council business by ensuring that issues relating to the performance of entities are integrated into corporate risk management, performance management and governance reviews as well as financial and strategic planning activity. The council constitution should appropriately reference the entity

3.5 Business case for the entity

The council should have a clear understanding of what it wanted to achieve by establishing an entity and be able to articulate clearly what success looks like in terms of achieving social outcomes and a return on investment.

Form should follow function; the model adopted should derive from its intended purpose, not the other way round.

The decision-making process should have been informed by the development of a detailed business case, ideally using the HM Treasury Five Case Model, based on the Government's green book[2].

The business case should have been produced prior to the establishment of the entity and have set out the rationale, enabling stakeholders to review and challenge the establishment of the entity.

The business case should cover:

- a clear strategic case which identifies direct and indirect benefits
- a rigorous appraisal of the options available for delivering the service or desired outcomes
- the objectives of the entity
- the expected financial results of the company, together with any other relevant outcomes that the business is expected to achieve

[2] The Green Book is issued by HM Treasury on how to appraise policies, programmes and projects. It also provides guidance on the design and use of monitoring and evaluation before, during and after implementation.

- the investment and resources required to deliver the objectives of the entity
- any risks involved
- other important legal, commercial and financial considerations for setting up a company including company law issues; the cost of bidding for contracts; tax liability (corporation tax and VAT); procurement law and state aid/subsidy rules and employment law (TUPE[3] and pensions)

Market conditions and changes will affect commercial activity and therefore assumptions underpinning the activities of an entity may need to be revised over time.

Once set up, councils should continually re-assess the business case and challenge the ongoing existence and relevance of their entities and review the extent to which their objectives remain relevant over their lifetime.

EVIDENCE

C15 A business case which assessed the risk involved in establishing the entity and recommended its establishment, taking account of other potential delivery models, should be available to review

C16 Objectives of the entity should be clearly defined and documented, and regularly reviewed to ensure that its operation continues to support council policy and strategy, including periodically reviewing the business case to ensure it is still valid

3.6 Agreements with the entity

The council should have commercial agreements which set out any assistance provided to the entity and the terms for that assistance, such as a loan or a parent guarantee.

The terms of any support provided to the entity in the form of goods, services or staff should be captured in appropriate legal agreements.

Where there is a service contract between a council and an entity, contract management arrangements should be established and may include a joint liaison committee to review issues (relating to performance, disputes, or changes in the relationship, for example).

[3] Transfer of Undertakings (Protection of Employment) regulations (TUPE) www.gov.uk/transfers-takeovers

Additional agreements should be established as required, including data protection and information sharing protocols.

EVIDENCE

C17 Agreements should be documented between the council and the entity for any support or services provided by either party to the other party

C18 All agreements should be clear, up-to-date, and regularly monitored and reviewed, with any changes to agreements documented so that a clear audit trail exists

3.7 Avoiding and managing conflicts of interest

Local authority members and officers should be aware of potential conflicts of interest when carrying out their roles for their authorities, or when acting as directors of trading companies.

Council officers and members also have fiduciary duties to the council. Board directors' first duty is to act in the best interests of the company. Situations can inevitably arise where the same person will be a decision maker or advisor both for the council and one of its entities. For example, in matters of reporting, contractual discussions, investment requests or resourcing agreements. It is therefore important to consider the rationale for having members or officers on boards of companies with a close association with the nature of their work.

When acting as director of the entity, a council officer or member is obliged to act in the best interests of the entity. As the Institute of Directors' Corporate Governance Guidance and Principles states "**an important principle of company law is that directors have a duty to promote the success of the company as a whole. They are specifically prohibited from directing the activities of the company in favour of themselves or particular shareholders and/or stakeholders**".

If there is a risk of a conflict of interest, the officer or member should not act for both the council and the entity unless they agree that they are both seeking the same common objective.

Conflicts of interest can arise in a wide variety of ways. The council should use its internal and external audit functions to regularly review the governance arrangements relating to all of its entities to ensure that potential conflicts do not arise.

Examples of areas where conflicts can arise include:

- **elected members appointed as board directors of the company. A board director's first duty is to act in the interests of the company which may present a conflict with their political responsibilities. It is particularly not advisable for cabinet members with budget responsibility for a particular service to sit on the board of a company delivering that service as this means that the company cannot be held to account**
- individuals acting as representative for both the entity and the council. For example, given that it is likely that certain decisions of the shareholder will require ratification by the Section 151 officer, it is not considered good practice for that post-holder to hold a position with a council owned entity. Similarly, regeneration companies should only have officers on boards who do not have direct managerial oversight, for example a director of public realm or place, as opposed to a head of planning
- holding a council role which involves potential oversight and scrutiny of the entity, while also holding a position with the entity. For example, an entity board member who also holds a position on the council's audit committee would clearly be conflicted
- holding a position as a company board member while having private financial or non-financial interests which may conflict or may be perceived to conflict with the role. For example, a company board member, or member of the family, having an interest in a supplier or competitor to the company)
- board members receiving benefit (such as gifts and hospitality) from third parties (such as potential suppliers to the company)
- the exploitation by a board member of any asset, information or opportunity related to the entity

Officers and members who hold roles with the entity must declare any interest they have in a proposed transaction in advance of the transaction being entered into. The declaration of an interest in an existing transaction must be declared as soon as reasonably practicable.

The council should have a formal policy to deal with conflicts.

All potential conflicts of interest should be referred to the council's Monitoring Officer for a decision about whether a conflict exists.

In the event of a conflict of interest, the Monitoring Officer should operate an "ethical wall" policy, whereby an information barrier is erected to prevent communication that could lead to the disclosure of information which is confidential to one organisation or the other.

Officers and members should report back to the council on their involvement in outside entities to which they have been nominated by the council. This should involve making themselves available for council scrutiny committees and other council governance forums which oversee the entity. However, they should not be obliged to publicly disclose commercially confidential information about the entity.

EVIDENCE

C19 There should be evidence that a culture exists whereby actual or potential conflicts of interests are identified, declared, and acted upon, including evidence of appropriate training across the organisation

C20 The council's constitution should contain clear and up-to-date policies and processes to consistently manage actual conflicts or potential conflicts of interest, including a clear process for investigations and procedures for appropriate disciplinary actions in the event of breaches

C21 The roles, responsibilities and reporting lines of officers and members who are involved in council oversight of the entities, the provision of services between the entities or the running of the entities should be clearly defined and documented

3.8 Council appointments to the board

The council should carefully consider nominations to the board, taking account of:

- the benefits of appointing independent directors to the entity
- the need to avoid council members and officers also being appointed to senior positions in the company, if such an eventuality is likely to lead to a conflict of interest

Potential appointees to the board must complete declaration of interest forms.

Appointments to the board should relate to the relevant post or office of the council, not to a specific individual. It follows that, if a council appointed director ceases to be an employee or office holder of the council, then they should automatically no longer be able to hold board membership.

The process for the appointment and renewal of directors should be set out in the articles of association, which should state those appointments which are wholly reserved to the council. For those appointments which are not reserved to the council, the company may establish a remuneration committee to make appointments and remuneration decisions and recommendations to the council.

Appointments should be based on a review of the skills, qualifications, diversity, and other attributes required for the role.

Where a board member is eligible for renewal and reappointment, this should be subject to considering their performance to date and skills, and the needs of the board.

EVIDENCE

C22 There should be evidence that all matters relating to appointments to the board are subject to a documented formal, rigorous, and transparent procedure based on merit and published objective criteria which also promote diversity. This could include evidence that the recruitment process has been competitive and transparent, for example by demonstrating that a formal process for advertising and selection has taken place. Board appointments should be approved by the shareholder

4
ENTITY GOVERNANCE ARRANGEMENTS

4.1 Introduction

This section provides a best practice checklist of issues to be considered when reviewing a wholly or partly owned entity, focusing on governance arrangements for the entity itself.

4.2 Articles of association

The entity should have articles of association, documenting its constitution and addressing purpose, conduct of meetings and appointment of directors[4].

For the purposes of applying the relevant exemption under procurement law, the articles for a Teckal company should be consistent with the need to demonstrate that:

- the council exercises over the company a control, similar to that which it exercises over its own departments
- more than 80% of the activities of the company are carried out in the performance of tasks entrusted to it by the controlling council or by other legal persons controlled by that council
- there is no direct private capital participation in the company[5]

EVIDENCE

E1 The entity's articles of association should be clear, up-to-date, and reflective of how the entity is run

[4] See under "Starting a company" at www.gov.uk/government/organisations/companies-house for model articles

[5] Regulation 12(1), Public Contracts Regulations 2015 www.legislation.gov.uk/uksi/2015/102/contents/made

4.3 Business planning

The entity should have an annual business plan which sets out its objectives and how the objectives are to be resourced and achieved. Key areas of focus should include:

- a description of the core offering and articulation of potential future services and/or innovations
- strategy and implementation; a description of the value proposition, underpinned by effective marketing, communications, and branding strategies
- financial break-even analysis, projected surplus or deficit, cash flow, balance sheet and reliance on trading income
- operations and management; an analysis of the entity's capacity and capabilities to fulfil its purpose, in terms of commercial skills, workforce planning, board development, support services, managing the supply chain and clients
- market analysis and a description of market trends and competitors

Requirements to meet the legal criteria in relation to any Teckal companies should also be reflected in the business plan.

EVIDENCE

E2 There should be evidence of an up-to-date business plan that is reflective of the current circumstances and environment in which the entity operates

4.4 Role and behaviours of the board

The board should operate openly and transparently. According to the Cadbury Report[6] "**the basic procedural requirements are that the board should meet regularly, with due notice of the issues to be discussed supported by the necessary paperwork and should record its conclusions**". Meetings on at least a quarterly basis would be considered good practice.

[6] The Financial Aspects of Corporate Governance – "The Cadbury Report"

The Cadbury Report states that "**the responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship**".

The Higgs Review[7] suggests that the role of the board includes:

- promoting the success of the company by directing and supervising the company's affairs
- providing entrepreneurial leadership within prudent and effective controls where risk is assessed and managed
- setting strategic aims and ensuring sufficient resources (financial and human) are available to meet objectives
- reviewing management performance
- setting corporate values and standards
- ensuring obligations to shareholders and others are met

The board should have processes to ensure that the entity continues to be financially viable, supported by the role of internal audit and its external auditor.

Larger entities or holding companies should have:

- an audit committee to provide independent scrutiny, challenge, and assurance
- a remuneration committee, which will manage appointments and remuneration decisions (where an appointment is not reserved to the council)

The board should ensure processes are in place to confirm how financial issues are to be dealt with including business planning, budget control, financial systems and financial monitoring and reporting.

The Cadbury Report recommends that boards should "**recognise the importance of the finance function by making it the designated responsibility of a director, who should be a signatory to the accounts on behalf of the board and should have access to the audit committee**".

[7] Review of the Role and Effectiveness of Non-Executive Directors – "The Higgs Review"

The board should undertake in-depth consideration of company matters that are deemed significant including new projects, exiting projects, approvals and endorsement of advice.

The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.

There should be a record of the essential functions and other matters which are reserved for board decision and cannot be delegated.

EVIDENCE

E3 There should be evidence that the board meets regularly to consider, review and record discussions and conclusions

E4 There should be evidence of delivery of strategies and plans, including scrutinising key operational and finance performance information

E5 There should be evidence of the desired culture and behaviours

E6 The company structures should be regularly scrutinised in order to ensure they remain fit for purpose

E7 There should be evidence that the board has clear policies and procedures for its members to ensure that actual or potential conflicts of interests are identified, declared, and acted upon

4.5 Role and behaviours of company directors

The Companies Act 2006[8] (sections 171-177) states that directors must:

- act within their powers
- promote the success of the company
- exercise independent judgement
- exercise reasonable care, skill and diligence
- avoid conflicts of interest
- not accept benefits from third parties
- declare an interest in proposed transactions or arrangements with the company

[8] The Companies Act 2006 www.legislation.gov.uk/ukpga/2006/46/contents

Directors of wholly or partly owned council entities must also act in accordance with the seven Nolan Principles[9]:

NOLAN PRINCIPLES

SELFLESSNESS
take decisions solely in the public interest (may conflict with board members duties as directors to a company)

INTEGRITY
should not be under any financial or other obligation to outside organisations or individuals

OBJECTIVITY
choices should always be based on merit

ACCOUNTABILITY
submission to public scrutiny and be held accountable for actions

OPENNESS
decisions should be made openly with reasons given

HONESTY
duty to declare any private interests in relation to public duties and actively take steps to resolve any interest that arises

LEADERSHIP
the above principles should be supported and promoted through example

EVIDENCE

E8 There should be evidence that directors have sufficient skills and experience to run the entity

E9 There should be evidence that directors' behaviours are aligned with the requirements of the Companies Act 2006 and the Nolan Principles as well as Cabinet Office's Code of Conduct for Board Members of Public Bodies[10]

E10 The scope of directors' authorities should be documented and clear to all parties

[9] The Seven Principles of Public Life – "Nolan Principles"

[10] Code of Conduct for Board Members of Public Bodies published by the Cabinet Office in 2011 as updated/ replaced in June 2019

4.6 Company board composition

Achieving the right board composition should facilitate good governance and minimise the scope for conflicts of interest.

The optimal size of a board should be between five and 10 directors, although this will be dependent on the circumstances of each entity.

Boards of wholly or partly owned council entities are often a mix of council officers, members, and independent directors. Board skills and expertise can be improved through the effective use of independent directors with both public sector and market specific experience. The UK Corporate Governance Code[11] advises that at least half the board (excluding the chair) should be independent non-executives.

Appointments to the board should be subject to a formal, rigorous, and transparent selection procedure based on merit and published objective criteria.

Board composition and individual director performance should be reviewed periodically to evaluate board composition, the effectiveness of individual contribution, and how effectively board members work together to achieve the objectives of the entity.

EVIDENCE

E11	There should be evidence that the board has a diverse membership with the collective skills and attributes needed to lead the entity effectively
E12	There should be evidence that board membership is reviewed regularly for composition and fitness for purpose

4.7 The board and risk management

The board should have ultimate responsibility for risk management within the entity and ensure that appropriate risk management arrangements are in place.

The board should regularly review risks and how they are being managed, and potentially delegate the detailed scrutiny and evaluation of risk to a committee.

[11] The UK Corporate Governance Code, Financial Reporting Council, July 2018 www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf

The board should be aware of its appetite for risk and determine the risk profile for the entity. The board's approach to risk should be proportionate and appropriate to its model. For example, an entity which has borrowed money from the council and needs the council's support for working capital and revenue will have a different risk profile to a trading company which relies exclusively on external revenue.

EVIDENCE

E13 There should be evidence that the board understands the organisation's risk profile and the effectiveness of key controls and regularly reviews risks and risk appetite

4.8 Board members' skills and development

Training should cover legal roles and responsibilities, company directors' roles and companies generally. The training should include responsibilities under the Companies Act 2006, Insolvency Act 1986[12], Bribery Act 2010[13], Modern Slavery Act 2015[14], Data Protection Act 2018[15] and Health and Safety at Work etc. Act 1974[16].

The entity should seek a board which includes a range of skills and backgrounds including commercial, financial, business development, technical, legal and HR experience. Those skills may either be provided by council nominees or by engaging non-executive directors.

[12] The Insolvency Act 1986 www.legislation.gov.uk/ukpga/1986/45/contents

[13] The Bribery Act 2010 www.legislation.gov.uk/ukpga/2010/23/contents

[14] The Modern Slavery Act 2015 www.legislation.gov.uk/ukpga/2015/30/contents/enacted

[15] Data Protection Act 2018 www.legislation.gov.uk/ukpga/2018/12/contents/enacted

[16] Health and Safety at Work etc. Act 1974 www.legislation.gov.uk/ukpga/2018/12/contents/enacted

The Cadbury Report states that "**given the varying backgrounds, qualifications and experience of directors, it is highly desirable that they should all undertake some form of internal or external training; this is particularly important for directors, whether executive or non-executive, with no previous board experience. Newly-appointed board members are also entitled to expect a proper process of induction into the company's affairs. It is then up to individual directors to keep abreast of their legislative and broader responsibilities**".

There should be an annual evaluation of board, committee, chair, and director performance. UK Corporate Governance Code suggests that the chair should consider having this evaluation externally facilitated.

EVIDENCE

E14 There should be documented evidence that the board regularly undertakes a skills audit to ensure that it has an appropriate balance of skills and experience

E15 There should be evidence of ongoing professional training provided to ensure that all board members are up-to-date in their understanding and supported in their roles

4.9 Role of executive directors and non-executive directors

It is important to distinguish between the roles of **executive director, non-executive director and independent non-executive director**. Legally, they all share the same individual and collective duties and responsibilities. However, they should all bring a distinct focus to their roles.

The role of executive directors will vary greatly from entity to entity. Essentially, they are focused on running the entity's business activities and implementing the board's plans and policies. They may be expected to be board members, although this is not essential.

Non-executive directors have a wider role, providing independent and constructive challenge.

Council appointees to boards will generally be expected to fulfil the role of a non-executive director. However, council officers who are appointed to undertake a dedicated role within an entity may be appointed in an executive capacity, such as to undertake the role of a finance director.

The Cadbury Report states that "**non-executive directors have two particularly important contributions to make to the governance process as a consequence of their independence from executive responsibility... The first is in reviewing the performance of the board and of the executive. The second is in taking the lead where potential conflicts of interest arise**".

Independent non-executive directors are external appointees who do not hold a role as officers or members within the council. Entities should consider the use of independent non-executive directors to improve the quality of board representation. These appointments should be external to the council and provide detailed experience and insight into the company's particular area of activity as well as providing independent and constructive challenge.

According to Higgs[17], the role of a non-executive is to:

- challenge, and contribute to the development of the company's strategy
- scrutinise performance of management in meeting agreed goals and monitor reporting of performance
- satisfy themselves on the accuracy of financial information and that financial controls and risk management are robust and defensible
- determine executive directors' remuneration and have a prime role in appointing/removing senior management

Higgs describes a number of desirable personal attributes and behaviours of non-executive directors:

HIGGS' DESIRABLE PERSONAL ATTRIBUTES AND BEHAVIOURS OF NON-EXECUTIVE DIRECTORS	Sound judgement and an enquiring mind	Knowledge of the business, its operating environment, and issues it faces
Integrity, probity, and high ethical standards	Objectivity as the basis for questioning and challenging accepted thinking of executives	Strong interpersonal skills

[17] Review of the role and effectiveness of non-executive directors, Department of Trade and Industry, January 2003 web.archive.org/web/20080910081648/http://www.berr.gov.uk/files/file23012.pdf

EVIDENCE

E16 There is evidence that the role of executive directors is clearly defined and documented

E17 Non-executive directors are in place to bring an independent judgement to bear on issues of subject matter expertise, strategy, performance, resources including key appointments, and standards of conduct

E18 There is documented evidence that the board values the role of non-executive directors, and their views are influential in the board's decisions

4.10 The role of the board chair

The Cadbury Report describes how the chair's role in securing good corporate governance is crucial. Chairs are primarily responsible for the workings of the board, for its balance of membership subject to board and shareholders' approval, for ensuring that all relevant issues are on the agenda, and for ensuring that all directors, executive and non-executive alike, are enabled and encouraged to play their full part in its activities.

Chairs should be able to stand sufficiently back from the day-to-day running of the business to ensure that their boards are in full control of the company's affairs and alert their obligations to their shareholders.

In addition, the chair should have the following leadership responsibilities:

- formulating the board's strategy
- promoting the efficient and effective use of staff and other resources
- delivering high standards in terms of integrity and propriety

The Cadbury Report states that the chair's role "**should in principle be separate from that of the chief executive. If the two roles are combined in one person, it represents a considerable concentration of power… therefore, there should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision**".

EVIDENCE

E19 There is evidence that the chair provides clear board leadership, supporting the directors and chief executive and taking account of the shareholders' views

4.11 Financial management

The business plan and business planning process are critical parts of the governance culture and environment. They are the basis for monitoring financial performance and should also feed into the medium-term financial planning of the council in situations where it expects to receive dividends, loan repayments, capital receipts or provide financial support in terms of working capital or longer-term finance.

Board reports should feature clear articulation of the current financial position of the company in terms of its trading position (income and expenditure), liquidity (cash flow) and solvency (balance sheet).

The company should have an independent financial status from the council. This should include separate bank accounts and designated signatories.

The financial transactions of the company should be recorded on the company's own, separate ledger system and the council should be able to demonstrate how the results of the company are consolidated into its own group accounts.

The company should have a set of documented financial policies and procedures which describe areas such as borrowing and overdraft limits and levels which are reserved for council approval. These reserved matters should also be documented in the company's articles of association.

It should operate a system of internal controls that are consistent with these policies and procedures. The company's internal controls should be the subject of periodic testing by internal auditors, whether they be the council's own internal audit function or separately appointed by the company.

EVIDENCE

E20 There should be a fully documented and approved business plan that is consistent with and no more than 12 months older than the previous business plan. The changes within the updated business plan should accord with the trajectories that are apparent from monthly financial and non-financial performance reports

E21 The financial transactions and values attributable to the company within the council's medium term financial plan should agree with the projections in the business plan

E22 Board reports should include clear presentation of the monthly income and expenditure position of the company as well as a cash flow statement and balance sheet

E23 There should be evidence of an annual audit letter from the council's external auditors, confirming the degree of confidence they hold in respect of consolidation or treatment of financial instruments entered by the company

E24 Documented financial policies and procedures should be available

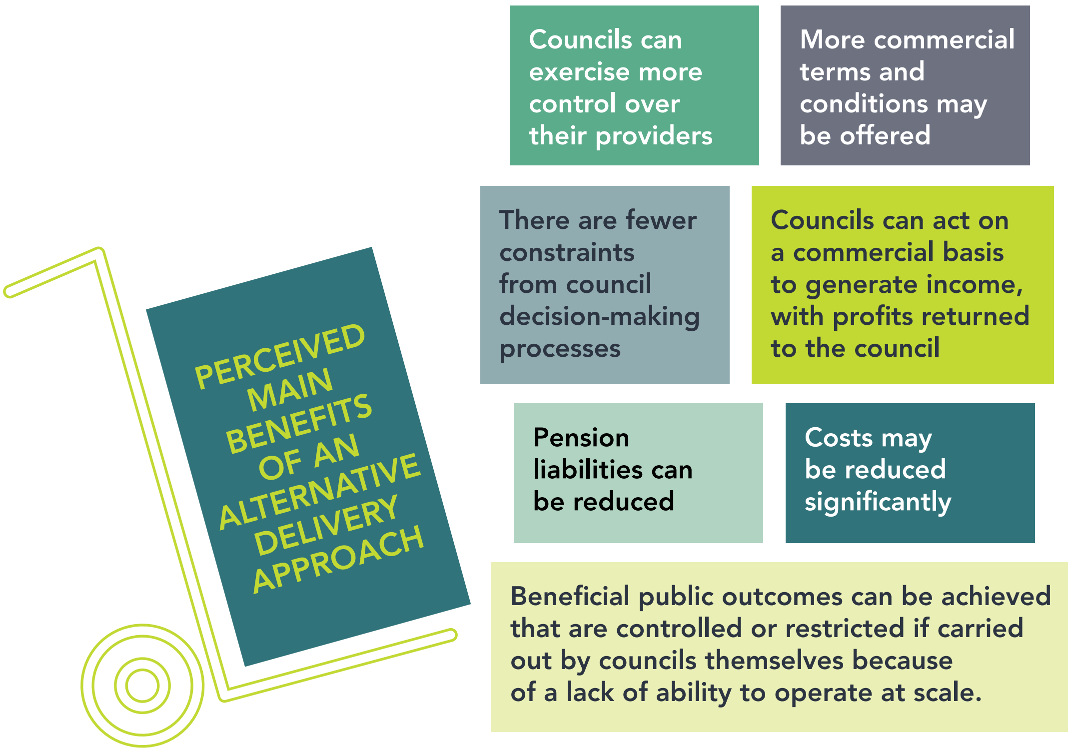
E25 There should be evidence of an effective annual internal audit programme

5 ALTERNATIVE DELIVERY MODELS

5.1 Introduction

The Localism Act 2011[18] gave local authorities new and broader general powers of competence to trade and since that time there has been a surge in the creation of new companies. These range from wholly owned companies, joint ventures (JV) with either the public or private sector, ranging from the highly commercial to social enterprises.

The main benefits of an alternative delivery approach are perceived to be:



Establishing an alternative delivery approach such as a wholly owned company or joint venture is a significant strategic decision that should be given consideration with an appropriate level of analysis and attention. This should include the development of a business case following HM Treasury best practice guidance set out in Section 5.9.

[18] Localism Act 2011 www.legislation.gov.uk/ukpga/2011/20/contents/enacted

This section of guidance aligns with HM Government's Sourcing Playbook Delivery Model Assessments[19] process. It covers the approach councils should adopt and suggests questions they should address when thinking about setting up a new Local Authority Trading Company (LATCo). This applies to all types of company, whether they are wholly owned by one authority or a JV with one or more partners. In some instances, an authority will form a JV with two or more local authorities or with a private sector partner. All need careful consideration and have different challenges.

5.2 Framing the challenge

The initial challenge is to determine whether the council's service and the outcomes it delivers can be best delivered by alternative means.

If there is insufficient oversight and assurance placed on this fundamental analysis, particularly where a commercial initiative is progressed at speed, this will create significant operational, commercial, and reputational risks.

From the outset, it is important to clarify the objectives, timescales, and drivers of change.

A dedicated core team of suitably skilled individuals should be appointed that will input into the process. This may include finance, commercial, legal, programme and operations and technical experts.

The approach to governance needs to be established, as well as a clear understanding of the decision-making process.

Identifying the final approvers of the recommendations to establish (or not) LATCos is critically important.

A good understanding of all the key stakeholders who will be involved in and/or affected by the outcomes needs to be developed, ensuring that all relevant parties can be engaged in the assessment process.

There should also be suitable administrative, legal and project management support available to keep things on track.

[19] Delivery Model Assessments assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987129/Delivery_model_assessment_guidance_note_May_2021.pdf

5.3 Defining the service, delivery model options and data inputs

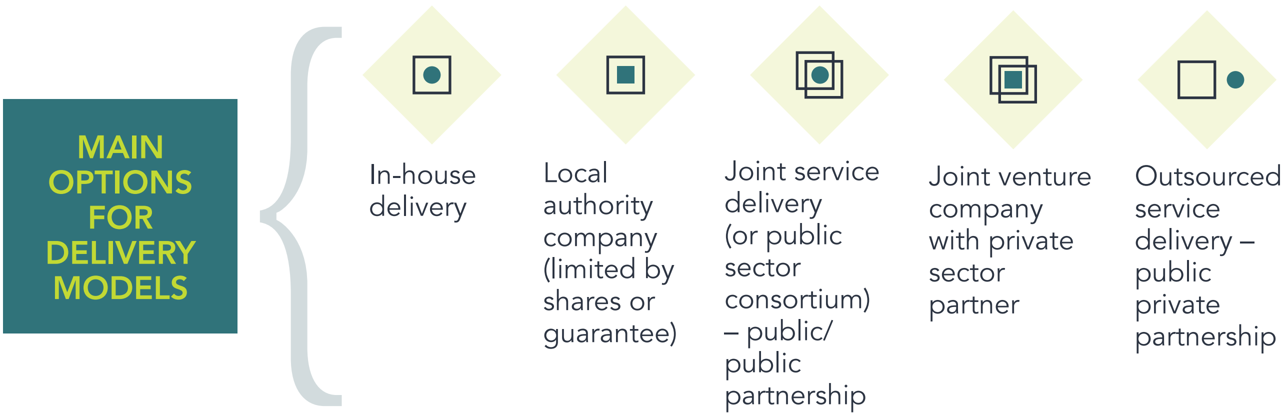
It is important to identify the service components to be delivered, the outcomes sought and the options for how they might be delivered. It is essential to develop a clear definition of these before starting the delivery model assessment to enable an effective comparison of alternative delivery models.

Once a long list of options has been developed, potential delivery models should be short-listed based on critical success factors, practical limitations, and discussions with senior stakeholders.

The final list of potential delivery models should be signed off at member and senior officer level before evaluation.

5.4 Potential options for consideration

In this section, we outline the main options for delivery models that local authorities may choose to consider:



Local authority companies range from Teckal companies (operating akin to a council department) through to fully commercial models. They may be single entities or a group combining both types of entity, with or without a holding company.

If it wishes to consider a company model, the council will need to decide which is the most appropriate model, depending on the nature of the activity and the rationale for transferring the service into a company e.g. is it a service that would be more efficiently delivered at arm's length back to the council, or is there a commercially viable service capable of producing returns to be distributed back to the council?

The way in which the council acts as shareholder will be different in each case. If the company is a commercial one, the council will need to allow it greater freedoms, including allowing it to adopt its own terms and conditions. The company must also procure its own back-office services. Other factors, such as the terms and conditions of staff, corporation tax considerations and cross-charging for services will also need careful consideration.

A description of potential options is provided below, including an overview of the benefits and risks of adopting each model. It should be noted that this list is not exhaustive, and the specific options considered by each council will differ depending on its priorities and local circumstances.

The most important thing is that councils should not jump to a specific model without a comprehensive consideration of the potentially viable options for delivering the outcomes required. For example, in addition to the option of establishing a company or participating in a joint venture, councils may consider other options including in-house delivery, outsourcing, and sharing services with another public body.

In-house delivery

Description	**This option involves services/functions being delivered in-house**
Benefits	The council retains full control of service delivery and of any efficiencies achieved Existing skills and knowledge of service are retained Familiarity of relationships, experience, and expertise
Risks and issues for consideration	Ability to invest in, resource and upskill the service/function may be constrained No benefits of scale or sharing of resources/expertise All risk and responsibility retained by the council Options for trading commercially with the private sector are restricted Local Government Pension Scheme pension costs continue

Council owned company (for example, company limited by shares or company limited by guarantee)

Description	**This option involves the council establishing a company** The company limited by shares model is designed for profit distribution to the participating organisations A company limited by guarantee is not designed for profit distribution
Benefits	Limited liability for shareholders Ringfences risks and liabilities, but council still retains reputational risk Freedom from direct management or standing orders of the council. A company has the capability to employ its own staff. Employees can be given greater incentive to succeed through new employment opportunities and financial reward, thereby promoting cultural change and developing a commercial mind-set Under this model, commercially delivered incidental services can be provided to the private sector (under Section 95 of the Local Government Act 2003) Commercial focus on business plan and goals Flexibility for the company to buy/sell/hold assets
Risks and issues for consideration	Can be administratively time consuming both in terms of set up and ongoing running This model requires compliance with the requirements of the Companies Acts and the administration of setting up and operating a separate entity There are additional regulatory requirements to comply with e.g. company audit and annual returns. Income may be liable to corporation tax VAT structures will be changed Potential loss of control to directors whose primary duty is to the company, not the council Risk exposure will vary depending on whether services are provided solely to the council or more widely to external organisations On paper, the "limited by shares/guarantees" structure limits councils' liabilities. However, there is a question as to the extent to which a council would realistically allow a company to fail without meeting their liabilities. Consideration would be needed with regard to what interventions the council would make should the company make significant losses Potential for reputational damage to the shareholders in the event of non-performance

There are a range of legal structures that can be considered under this broad commercial entity option which may include Community Interest Companies (intended for social enterprises that wish to use assets and profits for public benefits, with mandatory asset lock and controls on dividends to reassure potential participants, donors, or investors) and Co-operative and Community Benefit Societies (organisations with social objects to run a trade or business for the benefit of the community).

Joint service delivery or public sector consortium (shared services)

Description	**Two or more councils or other public bodies join to effect service delivery and deliver better outcomes**
Benefits	Potential economies of scale Scope for seamless service delivery Sharing of skills and improved resilience
Risks and issues for consideration	Potential impact of future changes in political control Problem of co-ordinating objectives and requirements of each local or public body Problem of assimilating procedures and IT systems of each public body Available capital will not necessarily be increased Long period of complex negotiation may be needed

Joint venture with the private sector

Description	**Council enters into a joint venture with a private sector partner to facilitate the provision or delivery of services, investment and/or development** This can include the creation of a separate legal entity
Benefits	May introduce capital resources which would not otherwise be available to the council Improved access to skills, resources, and systems of the partner (commercial acumen, technology) Potential wider opportunities for employees Risks in service delivery identified and allocated – enables some risk transfer Council influence can be preserved through controls on company decision-making Because of the partner's commercial expertise, faster to realise benefits

Description	**Council enters into a joint venture with a private sector partner to facilitate the provision or delivery of services, investment and/or development** This can include the creation of a separate legal entity
Risks and issues for consideration	Potentially significant time and costs involved in establishing the vehicle Additional regulatory requirements (company audit, annual returns) and potential tax implications Challenges in matching diverse organisational cultures in one entity Need for council vigilance in relation to commercial risks and cost structures Council's ability to challenge the activities of the partner should be assessed

Outsourcing

Description	**The council contracts with a private sector provider to provide certain services** This generally involves a total transfer of the service provision to the service provider
Benefits	The competitive nature of the procurement should ensure the most economic price Scope for investment in the service from the partner A mature market exists
Risks and issues for consideration	Potential concerns over loss of direct control of service and risk of becoming "locked in" with a single provider TUPE and pensions issues may prevent savings and lock in terms and conditions that would otherwise change over time Potential loss of key people from the council Additional costs of client-side arrangements Intense public scrutiny and reputational damage if the service provider performs poorly A poor service will not automatically improve through outsourcing. Business transformation will also be necessary

5.5 Establishing strategic and operational evaluation criteria

There are many potential issues to consider in the selection of a delivery model.

Evaluation criteria will be specific to the service or function under consideration, but the following areas give some examples of the potential issues that might help to determine the most appropriate strategic approach for delivery.

Criteria	Issues to consider
Finance	What level of savings/income generation is desired?
Control	To what extent does the council want to have direct control over the service?
Strategy and policy	How well does the delivery model align with corporate strategies and policies?
Transition and mobilisation	How easy will it be to transfer existing services into the new model?
People and assets	What capabilities and skillsets are needed and what is the existing capacity (internal or in the external market)?
Service delivery	Is quality an issue? How will the delivery model help to deliver ongoing quality, innovation and continuous improvement?
Risk and impact profile	What degree of risk appetite is there? Have the risks that may impact the delivery of services or on the council's finances been identified?

Individual criteria should be given weightings reflecting the importance of that criterion to the council and the nature of the specific service.

The criteria should be signed off at member and senior officer level before the evaluation of the delivery options begins.

5.6 Assessing the cost and benefits of the options under consideration

A financial model should be used to help evaluate different delivery model options. For example, a council may wish to compare the expected cost and benefits of establishing and running a wholly or partly owned entity with the cost and benefits of other delivery models under consideration.

An appraisal of the company model against the in-house delivery model will typically focus on a comparison of the expected whole life cost of procuring a service from an outside supplier, including the cost of additional market factors such as risk and profit, against the whole life cost to deliver a service using internal resources and expertise.

5.7 Conducting the evaluation and aligning the analysis

A cross-functional team should evaluate each criterion against the agreed weightings.

Learning should be derived from objective evidence, past projects, and colleagues across the public and private sector (this may include engaging with the market) to test and sense-check findings. This assessment may be facilitated by external experts to assist the decision-making process e.g. with regard to financial or legal matters.

There are several critical success factors in completing a successful assessment:

- appropriate governance and sponsorship with appropriately qualified individuals
- senior leadership should be clear about why the evaluation is taking place, provide sponsorship, clear governance, and allocate suitably experienced and skilled individuals
- good availability of input data
- data should be available to input into the model design and evaluation
- informed strategic and operational criteria
- independent facilitation should take place to bring together stakeholders, clarify objectives and drive credible outcomes
- realistic timelines
- enough time should be allocated to run a comprehensive process

5.8 Key questions at the evaluation stage

Specific questions should be asked when evaluating the viability and benefits of establishing a new commercial entity.

Criteria	Issues to consider
Strategic fit	How will the delivery model ensure delivery of strategic objectives, such as social value? What will be the internal council impact on officers and elected members (including training and recruitment implications), service and departmental structures, staffing requirements, and financial budgets?
Legal and financial	What is the optimum legal authority for activities which the new activity will pursue? What is the most appropriate and beneficial legal form and structure for a new entity (taking account of the objectives of the council)? What external legal and financial obligations will be placed upon the entity and to what extent will these impact upon the objectives of the council and the relationship between the council and the new entity?
Governance and risk	Who will control the entity and what does that mean for governance, leadership, and the legal status of the entity? What is the optimum form of and limits to the relationship between the entity and council officers and elected members? How will performance be managed and monitored? What are the commercial and operational risks that relate to the establishment of the new entity? Who is best placed to manage these risks and how might they be mitigated?
People and assets	Is there a clear understanding of TUPE considerations or asset transfer/ownership considerations? Has the council ensured it has sought legal and commercial advice on any issues and considered potential pension liabilities?

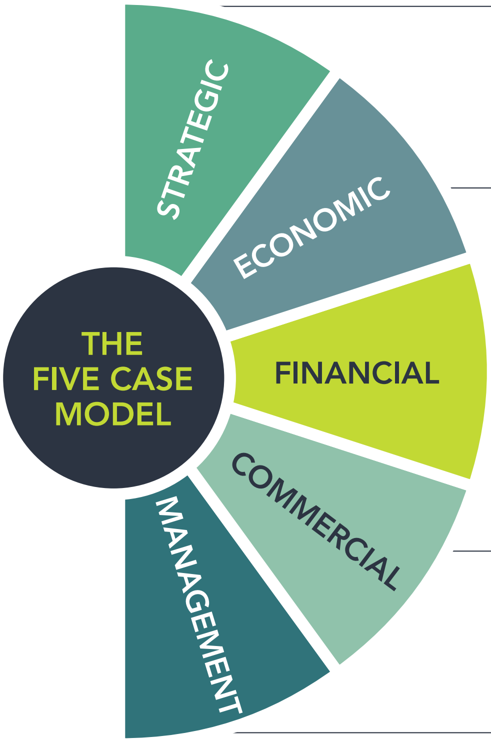
Criteria	Issues to consider
Commercial	Has sufficient data on market demand both locally and wider afield been gathered and investigated? Has sufficient financial, operational, past performance and governance data on potential competitors been gathered and interrogated? Has the impact of the new entity been considered on existing local infrastructure and particularly on public, private and third sector organisations that are currently operating in the market sector that the entity will enter? Does the impact that has been considered include financial and relationship issues? Does the entity intend to trade and if so, will this be with other local authorities? Or to a wider market?
Stakeholders	Is there evidence of support of relevant members and senior officers in relation to the establishment of the new entity?
Skills and capability	Have suitably qualified subject matter experts been engaged to provide appropriate input into the evaluation? Has suitable and appropriate specialist financial and taxation advice been sought from independent consultants?

5.9 Developing a business case

Before setting up a company a council must prepare a business case. This should follow the HM Treasury Green Book approach to public sector investment, adopting the HM Treasury Five Case Model, as set out in the Guide to Developing the Project Business Case, Better business cases: for better outcomes[20]. The purpose of the business case is to prove that the proposal is viable and that it will demonstrate value for money. The best practice approach is the follows the three-stage process of Strategic Case (decision to conduct a detailed appraisal); Strategic Outline Case (decision to develop and take forward); and Full Business Case (decision to implement).

[20] Guide to Developing the Project Business Case, Better business cases: for better outcomes assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/749086/Project_Business_Case_2018.pdf

The diagram below sets out the key elements to be included in each of the five cases in the HM Treasury Five Case Model:



The strategic case – overarching aims and what the new model it is intended to address

The economic case – identification and appraisal of options, understanding of risks and benefits

The financial case – overall affordability and impact on council's own finances and Medium Term Financial Strategy including impact on back-office services and recharges

The commercial case – identification of scope of services, risks, contractual arrangements including payment mechanism and staff considerations

The management case – defining the procurement strategy (including ensuring compliance with subsidy control legislation) and project management for implementation

5.10 Key activities at business case stage

Specific activities should be undertaken when developing the business case for the establishment of a new commercial entity. They include activities to develop and communicate the business case.

Criteria	Issues to consider
Strategic	What are the compelling reasons for establishing the entity and what should be achieved? Which options have been considered and what are the reasons for selecting a commercial entity as the way forward? Which form and type of entity has been chosen as the preferred option and what are the reasons for that choice? What are the desired outcomes and objectives and how do these fit with and contribute to the overall strategy of the council? This should include consideration of any dependencies with other projects, programmes or initiatives Why it is the right time to establish the new entity?

Criteria	Issues to consider
Legal and financial	What are the legal considerations relating to the establishment of the entity? What levels of control and freedom are required for the organisation? What set-up costs will be incurred by both the entity and the council? Has the high-level viability of the new entity been assessed? Are there any affordability issues given other commitments? Where appropriate, how will the new entity enable the maximisation of possible commercial and grant funded income streams, and the minimisation of VAT and other taxation impacts? What financial, legal, taxation and operational advice has been obtained from external consultants and other sources? What formal decisions need to be made and are they council (budget/policy framework) or executive (operational, contractual etc) functions?
Governance and risk	What are the key risks and how they will be managed? Who will be responsible for the overall management of risks? The oversight, audit, scrutiny and decision-making relating to the company needs to be established. For example, who will sit on the company board? Those elected members and officers who are not on the board must satisfy themselves that the company is acting in the council's best interests through other mechanisms such as a shareholder committee
People and assets	Has advice been sought on staffing issues, including TUPE arrangements, union negotiations and pension transfers?
Commercial	Has the competitive landscape been assessed, as well as the positioning of the new entity within that landscape? What will be the impact on the local and wider operating environment and market?
Stakeholders	What is the appetite for change, including stakeholder engagement and the level of support provided?
Skills and capability	What are the capabilities of existing staff to oversee and manage the new entity and what will be the future training and recruitment requirements?

5.11 Recommendations and approvals

From the outset councils should be clear about the assurance and approval process at each stage. A board or cabinet decision should be made at each stage to progress, or to stop the process, if a viable option cannot be moved forward.

5.12 Key activities prior to approval

Specific activities should be undertaken prior to the council approving the establishment of a new commercial entity.

Criteria	Activities to be undertaken
Legal and financial	Ensure all legal, financial, taxation, operational and governance duties, responsibilities and obligations of the chosen legal form of entity are understood and communicated to all officers and members and all potential executives and non-executives of the new entity Ensure that the proposed arrangements comply with procurement and state aid legislation Ensure that all external legal, financial, taxation and operational advice has been understood and acted upon Confirm the financial, legal, and reputational impacts if the entity fails
Governance and risk	Identify possible exit or alternative strategies if the new entity is unsuccessful or there is a change in strategy within the council Identify and clarify the council officer and/or member involvement on the entity board
Commercial	Ensure understanding of updated realistic demand projections based upon third-party sector expertise Ensure that monitoring information requirements and arrangements are clearly identified in both the council and the new entity

5.13 Implementation

Once the final delivery model recommendation has been signed-off through appropriate governance forums there should be a clear plan in place for implementation.

5.14 Key transition activities

Specific transition activities should be undertaken prior to the formal establishment of the new entity.

Criteria	Activities to be undertaken
Strategy and policy	Ensure that arrangements are in place for both leading the new entity and leading the transition to put it in place
Legal and financial	Confirm that the choice of entity delivery vehicle chosen maximises the possibility of commercial and grant funding income streams and minimises the impact of VAT and other taxation and is based on clear analysis of external legal, financial, taxation and operational advice Test the adequacy of the entity's opening financial projections including that the opening cash flow arrangements are adequate Confirm any contract arrangements, including arrangements for annual review, initial contract length and projected longer term budget impacts on both the council and the entity Ensure that adequate financial controls are in place Ensure that the formation and start-up of the entity has been notified to all relevant statutory and regulatory bodies Confirm that any ongoing services or assets that might be provided by the council are underpinned by agreements between the parties and can legally be provided, including consideration of the leases and/or licences relating to all assets and buildings to be used by the entity Ensure that the entity's systems and processes, including financial and payroll processes, are fit for purpose Ensure that the council have adequate insurance cover for the new entity's liabilities and assets Ensure that the entity's articles of association and other governing documents are fit for purpose and allow the organisation to fulfil its obligations and meet its objectives
Governance and risk	Confirm that the business case still makes sense in terms of funding, affordability and expected benefits Ensure that the plan through to completion of transition is appropriately detailed and realistic, including risk management arrangements Identify and document service and financial risks Develop the performance measures and tools to be used

Criteria	Activities to be undertaken
	Confirm the limits of council officer and member involvement in the day to day operational and strategic management of the entity Ensure that potential conflicts of interest have been addressed for council members or officers who will also hold positions with the new entity Confirm that the necessary and appropriate assurance bodies such as auditors, have been appointed or are in the process of being appointed
People and assets	Ensure that all TUPE and pension transfer arrangements have been finalised Develop the processes for appointing entity non-executives, executives and any external appointments and commencing any recruitment processes
Commercial	Review the business model and commercial model and whether these appear to be viable given the overall environment within which the new organisation will be operating Develop a detailed, credible business plan which is subject to challenge and review
Stakeholders	Confirm that stakeholder support remains strong Develop and implement a public relations strategy
Skills and capability	Confirm that the right capacity and capability is in place to both transition to and then run the new organisation Develop requirements for training and support of officers and members and for prospective entity non-executives, executives and staff on new arrangements and relationships Identify areas of expertise and personnel to appoint to entity board

5.15 Review

Once the entity is operational, it should be subject to effective oversight and regular review. Sections 3 and 4 cover the governance arrangements which need to be in place, within both the council and entity, to enable that oversight and review.

6
STANDARD DOCUMENTS REQUIRED FOR A REVIEW

The person tasked with conducting a review of council corporate entities will depend on the nature of the entity, the financial risk of the entity's business, the expertise of the council officers and the activities carried out by the entity. A senior council officer who is not themselves involved in the operations of the entity may be appropriate if they have the relevant expertise. However, councils may wish to bring in external legal, financial or commercial advisors to provide independence and wider experience. This may be appropriate in certain cases, for example if the entity is about to move into a new stage of development and requires expertise of a particular nature. In other cases, the council may be able to resource this function itself, for example if it has a dedicated team responsible for operational oversight of the company such as an "intelligent client function".

When carrying out a review, documentation should be made available as evidence, to provide assurance that the governance structures and processes for managing risk are sufficiently robust and the entities are meeting councils' expectations. As a minimum, these documents should include:

12 months of minutes (to cover the full business planning cycle) for all entity boards, any shareholder group(s), and engagements between shareholder groups and entity board members

Key executive and scrutiny reports

The entity's business plan and other key documents which document financial and operational performance to date

Key governance documentation such as:

– articles of association

– shareholder's agreement

– members' agreement

– any financial agreements (covering any support or services provided by either party to the other)

Governance and structure charts and any descriptions of key roles and responsibilities for:

– the entity

– council oversight of the entity

The original business case which resulted in the creation of the entity and any updates

Terms of reference for:

– the shareholder role

– the board

– the entity's audited accounts

The risk logs for:

– the entity

– the council

The policies and processes to manage conflicts of interest for the council and the entity

Board member training plans

7
GUIDANCE CHECKLIST FOR ELECTED MEMBERS

When elected members are required to approve business cases, the following questions may be used in order to ensure that they are sufficiently assessed:

1. Are the objectives for establishing a new entity clear and do they align with the council's strategic aims and ambitions as well as providing benefit to the local community?
2. Have other options been considered and are the reasons clear and robust for selecting a commercial entity as the way forward?
3. Does the business case capture the views of key stakeholders including potential employees and clients of the new organisation?
4. What levels of control and freedom are required for the organisation? Does the business case address the levels of controls and freedoms required for the organisation and are these appropriate?
5. Do all appropriate set-up costs appear to have been included, including sufficient contingency?
6. Is the proposed solution for establishing a new entity deliverable (e.g. do the skills and capacity exist to set it up), does it offer value for money and is it affordable?
7. How will the council oversee the new entity including identifying and managing risks associated with it?
8. What financial, legal, taxation and operational advice has been obtained from external consultants and other sources?
9. Has the competitive landscape been assessed, as well as the positioning of the new entity within that landscape?
10. Does the council have an exit strategy in case the entity fails or if local priorities change and it is no longer required?

For members within the shareholder function

1. Is there a full and transparent audit trail of documented decisions in relation to the entity?
2. Is there an ongoing assessment of value for money and quality offered by the entity through an adequately resourced monitoring function, which takes account of factors such as changes to market conditions and council priorities?
3. Are business plans used to drive the performance of the entity against agreed targets?
4. Are external experts engaged and reliance placed on their advice to mitigate the council's own risk?
5. Is there satisfactory evidence of effective management of financial issues including budget control, financial systems and financial monitoring and reporting?
6. Is it clear how the council as shareholder is able to oversee and challenge the board of the company?
7. Is there an up-to-date shareholder's agreement which describes the powers of the board of the entity and how and when the shareholder might influence those powers (e.g. in relation to the council's role in recruiting board members) and is that adhered to?
8. Are officers undertaking the shareholder role provided with suitable training and support commensurate with the role?
9. Does the council have commercial agreements which set out any assistance provided to their companies and the terms for that assistance, such as a loan or a parent guarantee?
10. Are shareholders regularly updated regarding any risks relating to the council's shareholding in the company?

For members on the audit committee

1. Do they have assurance on the adequacy of risk management, internal controls and governance processes associated with the company?
2. Do they have regular oversight of the company's financial affairs and how it impact on the council?
3. Are they satisfied that any recommendations from external or internal audit reviews have been implemented?
4. Have they ensured that any relevant risks relating to the company are included in the corporate risk register?

As a member of a scrutiny committee

1. Was the process for approving the business case for the company and the decision to establish a new entity sufficiently robust and subject to adequate due diligence, including external challenge?
2. Is the council's activity in relation to wholly or partly owned companies underpinned by a clear and up to date commercial strategy?
3. Is it clear how the co-ordination of the activity of the various external auditors across wholly or partly owned companies and other council investments is achieved?
4. Is there sufficient clarity regarding the leadership's risk appetite for investments, including establishment of commercial entities?
5. Are risks relating to wholly or partly owned companies managed as part of the council's overall risk management approach, with appropriate escalation and reporting?
6. Is there a clear governance framework which underpins arrangements for overseeing and engaging with the council's companies to ensure the council's interests are safeguarded e.g. clear committees and associated terms of reference?
7. Does the council strike an effective balance between its role as shareholder of a corporate entity and its role as a public body in receipt of public funds e.g. where the company requests a loan?
8. Is there evidence that the council regularly undertakes an objective assessment of the success of its companies and of how they support its policies and strategies, making changes where necessary?
9. Is there sufficient capacity and capability in place to monitor the performance of its commercial entities and to fulfil the council's shareholder role?
10. Are broader governance systems fit for purpose in the context of the council's commercial activity, for example is the council satisfied with the board membership of the company and the way in which it ensures sufficient oversight?

8
KEY REFERENCE DOCUMENTS

Code of Conduct for Board Members of Public Bodies published by the Cabinet Office in 2011 as updated/replaced in June 2019

This code sets out the personal and professional standards expected from non-executive board members of UK public bodies and forms part of their terms of appointment. The 2019 code includes new provisions making clear that bullying, harassment, or other discriminatory behaviour will not be tolerated. It also introduces a new requirement for the board member to notify the sponsor department of any bankruptcy, current police investigation, unspent criminal conviction, or disqualification as a company director. The new code also reminds office holders of their role in promoting diversity and inclusivity within their organisation, including at board level.

The Seven Principles of Public Life – "Nolan Principles"

The Seven Principles of Public Life outlines the ethical standards those working in the public sector are expected to adhere to. They were first set out by Lord Nolan in 1995 in the first report of the Committee on Standards in Public Life and are included in a range of Codes of Conduct across public life.

The Financial Aspects of Corporate Governance – "The Cadbury Report"

This report was published in December 1992. The committee, chaired by Sir Adrian Cadbury, had a remit to review those aspects of corporate governance relating to financial reporting and accountability and to make recommendations to raise standards in corporate governance.

The 2018 UK Corporate Governance Code

This code builds on the Cadbury Report, revising and expanding the guidance to take account of the increasing demands on the UK's corporate governance framework.

Review of the Role and Effectiveness of Non-Executive Directors – "The Higgs Review"

This report was authored by Derek Higgs and was published in January 2003. It was commissioned by the Secretary of State for Trade and Industry.

Corporate Governance Guidance and Principles for Unlisted Companies in the UK

This document was published in November 2010 by the Institute of Directors and European Confederation of Directors' Associations.

UK Government Investments Framework Document April 2018, Updated July 2020

A framework document drawn up by HM Treasury in consultation with UK Government Investments Limited, a private limited Government-owned company.

Nottingham City Council – Report in the Public Interest concerning the Council's governance arrangements for Robin Hood Energy Ltd – Grant Thornton

This report was issued in the Public Interest under section 24 and Schedule 7 of the Local Audit and Accountability Act 2014.
It addresses failings in the Council's governance for Robin Hood Energy (RHE), which was established in 2015 as a wholly owned not-for-profit subsidiary of the Council.

Public Interest Report – Governance issues in relation to remuneration of Council officers for work as Directors of City of York Trading Ltd February 2016 – Mazars

This report related to payments made in March 2015 by City of York Trading Ltd (a trading company specialising in the provision of temporary staff and wholly owned by the council) to two of the company's executive directors who were also officers of the council. It provides lessons to be learned and to ensure the future good governance of a council's relationships with its trading companies.

The Green Book guidance – HM Treasury, 2018

This document provides guidance for public bodies on how to appraise policies, programmes and projects. It also provides guidance on the design and use of monitoring and evaluation before, during and after implementation. It contains the "Five Case Model" – the required framework for considering the use of public resources to be used proportionately to assess costs and risks.

The Sourcing Playbook – Cabinet Office, May 2021

This document provides guidance on choosing the best model for delivering public services.

Guide To Governance and Lessons Learned for Local Authority Trading Companies – BDO, November 2021

This report sets out areas to consider when considering setting up a company or reviewing an established one. It covers both the council-side and company-side governance arrangements.

In Good Company – Grant Thornton, November 2018

This is one of a suite of reports covering different aspects of alternative delivery models in local government. It examines the success to date of local authority trading companies and sets out best practice steps to follow when considering setting one up including options appraisal and business case best practice. It also covers governance arrangements required to ensure an appropriate degree of oversight by the owning council. A number of case studies are included.

Local Authority Owned Companies: A Good Practice Guide – CIPFA, May 2022

This report considers the risks associated with local authority trading companies and sets out best practice, referring to examples. It focuses on identifying organisational goals, the process to find the right option to achieve these goals, and how to structure the organisation for success.

A Guide to Local Authority Companies and Partnerships ("LACAP") – Local Government Lawyer (Rob Hann), 2020

This is the latest updated guidance and provides a toolkit for those setting up, managing or advising local authorities and/or the companies they create. It provides a "road map" to follow in the footsteps of the many successful companies.

9
SUMMARY OF EVIDENCE

As stated in the introduction, the person tasked with conducting a review of council corporate entities will depend on the nature of the entity, the financial risk of the entity's business, the expertise of council officers and the activities carried out by the entity. This could be a senior council officer, who is not themselves involved in the operations of the entity or councils may wish to instruct external legal, financial or commercial experts to provide independence and wider experience.

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
Governance aims						
C1	There should be evidence that the council and senior management recognise the importance of establishing appropriate and proportionate governance arrangements for the oversight of entities	▸ The council has sufficient control to ensure that its investment is protected, appropriate returns on investment can be obtained and that the activities of the entity are aligned with the values and strategic objectives of the council ▸ "Teckal" companies demonstrate compliance with relevant exemption requirements under procurement law				
C2	There should be evidence of a culture of challenge and clarity relating to the purpose, efficiency, effectiveness, specific objectives, and freedoms of the entity	▸ There is a culture of challenge demonstrated by transparent scrutiny of the entity's operatives by the council in its shareholder role ▸ There is a clarity of purpose ▸ The entity has clear objectives ▸ The entity has sufficient freedoms to achieve its objectives				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
The council's shareholder role						
C3	There should be a clearly designated council shareholder role or function which is both understood and recognised by the council and the entity (and documented in terms of reference)	▸ The council has a designated "shareholder" role to represent its ownership of the entity ▸ The shareholder provides oversight of any decisions taken by the entity ▸ The shareholder provides a regular review of whether the entity provides the most effective vehicle to deliver the outcomes it requires and whether there are suitable alternatives ▸ The process for appointing a shareholder is set out in terms of reference				
C4	There should be clarity regarding the role of shareholder, with reserved matters clearly documented and updated as required, reflecting any changes made as the entity has developed, in a shareholder's agreement (or as set out in the company's governing articles of association)	▸ The shareholder's agreement describes the powers of the board and when the shareholder might influence those powers. Reserved matters may include: ■ approval of annual business plan ■ approval of significant contracts (above a specified threshold value) ■ admission of new shareholders ■ declaring dividends ■ charging/mortgaging assets ■ approval of activities not in the business plan ■ appointing/removing directors ■ buying/selling significant assets ■ taking out loans above a specified threshold value ■ winding up the company				

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	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
		▸ If the council is the sole shareholder, and a shareholder's agreement has been deemed unnecessary, an appropriate alternative document can be produced ▸ Evidence (minutes) that the meetings have taken place and that the relevant individuals have attended				
C5	There should be evidence that the individual or committee undertaking the shareholder role is provided with suitable training and support commensurate with the role and is independent of the relevant company	▸ The role and responsibilities of the shareholder are reviewed regularly by members ▸ Regular 360° reviews with representatives from the entity and the council are conducted ▸ The council has developed requirements for shareholder training				
C6	There should be evidence of formal periodic shareholder/chair/chief executive meetings with effective supporting papers to inform subsequent company board meetings	▸ The shareholder has a mechanism to communicate its views to the entity ▸ Periodic and effective shareholder/chair/chief executive meetings are documented				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
Council oversight, scrutiny, and governance framework						
C7	There should be documented evidence of transparent member and officer scrutiny, oversight, and approval of business plans	‣ There is a clearly defined governance framework underpinned by clear governance principles ‣ The role of the shareholder is separate from the board ‣ The business plan is current and updated at least annually ‣ The business plan is challenged and monitored by the shareholder function				
C8	There should be evidence of a clear set of KPIs that fall out of the business planning process	‣ The council regularly undertakes an objective assessment of how successfully each entity supports its policies and strategies ‣ KPIs are relevant to "SMARTER"[21] goals ‣ KPIs are reported and monitored within the context of the governance framework ‣ Remedial actions are implemented and monitored if KPIs are not met				
C9	There should be evidence that senior company staff are performance managed against KPIs	‣ Board, committee, Chair, and director performance is evaluated annually, including against agreed KPIs ‣ Performance management routines e.g. annual appraisals, connection to personal objectives				

[21] SMARTER goals are specific, meaningful, achievable, relevant, time-bound, evaluated and readjusted

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
C10	There should be evidence of ongoing assessment of value for money and quality offered by the entity through an adequately resourced monitoring function	▸ Contract management resource within the council where services are provided by the entity ▸ Regular reviews take account of value for money and performance quality, for example benchmarking against similar services at other authorities ▸ Budget setting and business planning takes account of such value for money assessment rather than approving entity payments "on the nod"				
C11	There should be ongoing assessment of risks relating to the entity, supported by processes to ensure that risks are managed as part of the council's overall risk management approach, with appropriate escalation and reporting	▸ The council regularly reviews risks relating to its entities and establishes whether they are effectively managed and scrutinised ▸ The council's overview and scrutiny committee (or equivalent) provides overview, pre-decision scrutiny and call-in decisions in relation to the entity				
C12	There should be evidence of a consistent approach across the council when it comes to engaging with its entities	▸ All council entities are managed in a consistent way with appropriate support, guidance and controls				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
C13	The council's shareholder function and auditors should have clear and unfettered access to audited accounts for its entities	▸ The council's audit committee pays specific attention to accounts and audit reports ▸ The council's internal auditors are able to gain clear and transparent access to financial information and oversight of internal controls				
Business case for the entity						
C14	A business case which assessed the risk involved in establishing the entity and recommended its establishment, taking account of other potential delivery models, should be available to review	▸ There is a clear and comprehensive business case that recommended the creation of the entity ▸ The business case took account of alternative delivery methods, with the case for the entity's creation having clear benefits over other methods ▸ The business case is up to date and reflects the current trading environment of the entity				
C15	Objectives of the entity should be clearly defined and documented, and regularly reviewed to ensure that its operation continues to support council policy and strategy, including periodically reviewing the business case to ensure it is still valid	▸ The objectives of the entity are clearly articulated, defined and documented ▸ The objectives are regularly reviewed ▸ The objectives continue to reflect council policy and strategy ▸ The business case and objectives are regularly reviewed to ensure they are still valid				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
Agreements with the entity						
C16	Agreements should be documented between the council and the entity for any support or services provided by either party to the other party	- The council and entity have clear and documented agreements for any services or support provided by either party to the other party - There is a clear process for escalation if the support or services agreements are not performed to either party's satisfaction				
C17	All agreements should be clear, up-to-date, and regularly monitored and reviewed, with any changes to agreements documented so that a clear audit trail exists	- Agreements for support or services between the parties are up-to-date and regularly monitored and reviewed - Changes to agreements are documented with a clear audit trail				
Avoiding and managing conflicts of interest						
C18	There should be evidence that a culture exists whereby actual or potential conflicts of interests are identified, declared, and acted upon, including evidence of appropriate training across the organisation	- All parties have been trained and demonstrate a commitment to avoiding and monitoring actual or potential conflicts of interest - Articles of association contain mechanisms for approving known or situational conflicts that are not materially detrimental to the arrangement				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
C19	The council should have clear and up-to-date policies and processes to consistently manage actual conflicts or potential conflicts of interest, including a clear process for investigations and procedures for appropriate disciplinary actions in the event of breaches	▸ There is a clear conflict of interest policy which is managed actively ▸ There is a clear process for investigating and dealing with breaches of the conflicts of interest policy ▸ Internal and external auditors review the management of conflicts of interest and escalate any concerns to the Monitoring Officer				
C20	The roles, responsibilities and reporting lines of officers and members who are involved in council oversight of the entities, the provision of services between the entities or the running of the entities should be clearly defined and documented	▸ Officers and members make themselves available to scrutiny and other council governance forums				
Council appointments to the board						
C21	There should be evidence that appointments to the board are subject to a documented formal, rigorous, and transparent procedure based on merit and published objective criteria which also promote diversity	▸ Board members have completed declaration of interest forms ▸ Appointments to the board are relevant to the post or office of the council ▸ Council appointed directors cease to be members if they leave their qualifying roles ▸ The process for the appointment and renewal of directors is set out in the articles of association				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
		▸ If there is a remuneration committee, relevant matters are referred appropriately ▸ Appointments are based on a review of the skills, qualifications, diversity, and other attributes required for the role ▸ Where a board member is eligible for renewal and reappointment, this is subject to considering their performance to date and skills, and the needs of the board				
Articles of association						
E1	The entity's articles of association should be clear, up-to-date, and reflective of how the entity is run	▸ The entity has articles of association, documenting its constitution ▸ The articles address the entity's purpose, conduct of meetings, and role and appointment of directors ▸ If the entity is a Teckal company, the articles demonstrate that the council exercises control				
Business planning						
E2	There should be evidence of an up-to-date business plan that is reflective of the current circumstances and environment in which the entity operates	▸ There is an up-to-date business plan, setting out the organisation's objectives and how these will be resourced and achieved ▸ Requirements to meet the legal criteria in relation to any Teckal companies are reflected in the business plan				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
Role and behaviours of the board						
E3	There should be evidence that the board meets regularly to consider, review and record discussions and conclusions	‣ The board meets regularly, and all decisions are recorded and documented ‣ Decisions are taken at the appropriate place, including deferral and recommendations of decisions on matters that are reserved for the shareholder				
E4	There should be evidence of delivery of strategies and plans, including scrutinising key operational and finance performance information	‣ The board has delegated detailed scrutiny to committees or directors with appropriate skills, including financial management ‣ The board challenges performance and key financial and operational reporting				
E5	There should be evidence of the desired culture and behaviours	‣ The board promotes the success of the company ‣ The board provides entrepreneurial leadership ‣ Prudent and effective controls are demonstrated where risk is assessed and managed ‣ The board sets strategic aims and ensures sufficient resources (financial and human) are available to meet objectives ‣ The board reviews management performance, including that of the chief executive/managing director and leadership team ‣ The board sets corporate values and standards ‣ The board ensures obligations to shareholders and others are met				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
E6	The company structures should be regularly scrutinised in order to ensure they remain fit for purpose	▸ The company structures are regularly reviewed ▸ Financial and performance benchmarking exercises are carried out regularly				
E7	There should be evidence that the board has clear policies and procedures for its members to ensure that actual or potential conflicts of interests are identified, declared, and acted upon	▸ The board regularly monitors conflicts of interest, including with suppliers and users				
Role and behaviours of company directors						
E8	There should be evidence that directors have sufficient skills and experience to run the entity	▸ Directors' skills align well to the organisation's purpose and objectives ▸ Directors are trained so that they are competent in undertaking their roles and responsibilities				
E9	There should be evidence that directors' behaviours are aligned with the requirements of the Companies Act 2006 and the Nolan Principles as well as Cabinet Office's Code of Conduct for Board Members of Public Bodies	▸ Directors: ▪ act within their powers ▪ promote the success of the company ▪ exercise independent judgement ▪ exercise reasonable care skill and diligence ▪ avoid conflicts of interest ▪ do not accept benefits from third parties ▪ declare an interest in proposed transactions or arrangements with the company				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
		Directors act in accordance with the seven Nolan Principles: ■ selflessness ■ integrity ■ objectivity ■ accountability ■ openness ■ honesty ■ leadership				
E10	The scope of directors' authorities should be documented and clear to all parties	Directors' authorities are demonstrated in a scheme of delegation The scheme of delegation includes reference to matters that are reserved for board decision and cannot be delegated				
Company board composition						
E11	There should be evidence that the board has a diverse membership with the collective skills and attributes needed to lead the entity effectively	There are between five and 10 directors on the board At least half of the directors are independent non-executives Appointments to the board are subject to a formal, rigorous, and transparent selection procedure based on merit and published objective criteria				
E12	There should be evidence that board membership is reviewed regularly for composition and fitness for purpose	Board composition and individual director performance is reviewed periodically to evaluate board composition, the effectiveness of individual contribution, and how effectively board members work together to achieve the objectives of the entity				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
The board and risk management						
E13	There should be evidence that the board understands the organisation's risk profile and the effectiveness of key controls and regularly reviews risks and risk appetite	▸ The board demonstrates ultimate responsibility for risk management within the entity and ensures that appropriate risk management arrangements are in place ▸ The board regularly reviews risks and how they are being managed ▸ The board is aware of its appetite for risk and determines the risk profile for the entity ▸ The board's approach to risk is proportionate and appropriate to its model				
Board members' skills and development						
E14	There should be documented evidence that the board regularly undertakes a skills audit to ensure that it has an appropriate balance of skills and experience	▸ The board regularly undertakes skills audits ▸ The entity has a board which includes a range of skills and backgrounds including commercial, financial, business development, technical, legal and HR experience				
E15	There should be evidence of ongoing professional training provided to ensure that all board members are up-to-date in their understanding and supported in their roles	▸ Regular training and updates cover legal roles and responsibilities, company directors' roles and companies generally ▸ Directors' training includes responsibilities under the Companies Act 2006, Insolvency Act 1986, Bribery Act 2010, Modern Slavery Act 2015, Data Protection Act 2018 and Health and Safety at Work etc. Act 1974				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
The role of executive directors and non-executive directors						
E16	There is evidence that the role of executive directors is clearly defined and documented	▸ Executive directors' roles are clearly defined and documented ▸ Directors' roles are focused on running the entity's business activities and implementing the board's plans and policies				
E17	Non-executive directors are in place to bring an independent judgement to bear on issues of subject matter expertise, strategy, performance, resources including key appointments, and standards of conduct	▸ Non-executive directors: ▪ challenge, and contribute to the development of the company's strategy ▪ scrutinise performance of management in meeting agreed goals and monitor reporting of performance ▪ satisfy themselves on the accuracy of financial information and that financial controls and risk management are robust and defensible ▪ determine executive directors' remuneration and prime role in appointing/removing senior management				
E18	There is documented evidence that the board values the role of non-executive directors, and their views are influential in the board's decisions	▸ The board values its non-executive directors, so that they are able to demonstrate: ▪ sound judgement and an enquiring mind ▪ knowledge of the business, its operating environment, and issues it faces ▪ integrity, probity, and high ethical standards ▪ objectivity as the basis for questioning and challenging accepted thinking of executives ▪ strong interpersonal skills				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
The role of the board chair						
E19	There is evidence that the chair provides clear board leadership, supporting the directors and chief executive and taking account of the shareholders views	The chair is primarily responsible for: ▪ the workings of the board ▪ its balance of membership subject to board and shareholders' approval ▪ ensuring that all relevant issues are on the agenda ▪ ensuring that all directors, executive and non-executive alike, are enabled and encouraged to play their full part in activities The chair is able to stand sufficiently back from the day-to-day running of the business to ensure their board is in full control of the company's affairs The chair is responsible for: ▪ formulating the board's strategy ▪ promoting the efficient and effective use of staff and other resources ▪ delivering high standards in terms of integrity and propriety				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
Financial management						
E20	There should be a fully documented and approved business plan that is consistent with and no more than 12 months older than the previous business plan. The changes within the updated business plan should accord with the trajectories that are apparent from monthly financial and non-financial performance reports	The business plan and business planning process are critical parts of the governance culture and environment				
E21	The financial transactions and values attributable to the company within the council's medium term financial plan should agree with the projections in the business plan	The business plan provides the basis for monitoring financial performance and feeds into the medium-term financial planning of the council in situations where it expects to receive dividends, loan repayments, capital receipts or provide financial support in terms of working capital or longer-term finance				
E22	Board reports should include clear presentation of the monthly income and expenditure position of the company as well as a cash flow statement and balance sheet	Board reports feature clear articulation of the current financial position of the company in terms of its trading position (income and expenditure), liquidity (cash flow) and solvency (balance sheet)				

	Evidence	What should you be able to find?	What evidence have you found?	RAG rating	Actions recommended	Responsible person/body
E23	There should be evidence of an annual audit letter from the council's external auditors, confirming the degree of confidence they hold in respect of consolidation or treatment of financial instruments entered by the company	▸ The council's external auditor has provided an annual audit letter annually ▸ The annual audit letter confirms the degree of confidence they hold in respect of consolidation or treatment of financial instruments entered by the company				
E24	Documented financial policies and procedures should be available	▸ The company has an independent financial status from the council, including separate bank accounts and designated signatories ▸ The financial transactions of the company are recorded on the company's own, separate ledger system and the council is able to demonstrate how the results of the company are consolidated into its own group accounts ▸ The company has a set of documented financial policies and procedures which describe areas such as borrowing and overdraft limits and levels which are reserved for council approval				
E25	There should be evidence of an effective annual internal audit programme	▸ The company operates a system of internal controls that are consistent with financial policies and procedures ▸ The company's internal controls are subject to periodic testing by internal auditors				

10
CASE STUDIES

At one council, the company was originally set up as a Teckal Company for specific services on behalf of the council. A business case was developed at the outset. The political leadership wanted to increase its remit and more services were transferred to the company, but without the same rigour as the initial tranche. The company struggled to compete in the commercial market externally and was encouraged to purchase the council's back-office services which were not fit for purpose for that business. The political desire was to keep the company going but in the end the company was wound up after accruing significant losses. The services are now run effectively in-house with limited trading consistent with the regulations.

A council had run a successful in-house direct labour organisation for many years and had developed a strong reputation for external work. The council believed that there was much more potential to trade, but to do this it would need to transfer the service into a company. After careful consideration through the process of an options appraisal to compare the current model with a company, a strong business case was developed. The 10-year model forecast significant turnover, based on the already established order book and growth estimates. Cost reduction was also forecast, through changes to more commercial terms and conditions and purchasing support services from the market rather than the council. To take maximum advantage of both the Teckal exemption and the commercial opportunities, two sister companies were created. This meant that the Teckal company could trade without the risk of breaching the exemption, allowing it to win work with other local authorities without having to undergo a procurement exercise; and the commercial arm could trade unimpeded in other sectors. Growth has been accelerated through the recruitment of experienced people from the commercial sector and transferring council employees onto pay packages that encourage more commercial ways of working. These initiatives have facilitated the change in culture needed to succeed.

Two councils set up a commercial trading business for back-office services. The ambition was to trade to other local authorities and generate dividends for both councils. However, the company struggled to achieve its turnover targets. The councils addressed this point by recruiting a managing director from the commercial sector. However, it became clear that the councils as joint shareholders were not aligned in relation to the ambition for the company and it was not receiving a clear steer regarding strategic direction. It therefore continued to operate at a level that could have been sustained by being in-house. The nature of the work did not lend itself to commercial opportunities and it did not have a brand name that other authorities could recognise and trust. The decision was taken to wind the company up.

Two councils went into a partnership with a recognised customer service private sector company through a contractual arrangement. The council staff in revenues and benefits and customer contact were transferred to the company via TUPE but the service continued to be run from one of the councils' offices with its branding. These enabled economies of scale and to allow the councils to take advantage of the latest forms of technology which further enabled efficiencies, thereby illustrating that creating a company is not necessarily the best option. Although not incorporated, the arrangement enabled the councils to receive a fee for any new authority they identified who signed up to have their services delivered as part of this group.

One council with an existing Teckal company for environmental services expanded its services by being directly appointed by two neighbouring authorities in a strategic alliance. One of these authorities had previously had an outsourced contract while the other was previously in-house. When the former's contract came to an end, they entered into a contract with the Teckal company which created greater flexibility than with the previous large-scale private sector provider. The Teckal company was able to be more flexible as needs changed due to customer demand and the requirement by members to develop more sustainable solutions. This flexibility enabled efficiencies to be realised more quickly.

11
FURTHER INFORMATION

Acknowledgement

We are extremely grateful to Trowers & Hamlins for their input and support in producing this latest version of the LATCo guidance.

www.trowers.com

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